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DEPT FOR EB: A/S SULLIVAN; SCA/CEN (O'MARA)
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TAGS: [ENRG](#) [EPET](#) [KZ](#) [PGOV](#) [PREL](#)
SUBJECT: KAZAKHSTAN: A/S SULLIVAN DISCUSSES ENERGY,
ECONOMIC PARTNERSHIP WITH PRIME MINISTER

Classified By: Ambassador John Ordway; Reasons 1.5(b) and (d).

11. (C) Summary: In February 4-6 meetings in Astana with Prime Minister Masimov and GOK cabinet members, A/S Sullivan and delegation communicated strong USG support for multiple oil and gas export routes (including potential Trans-Caspian pipelines), Kazakhstan's efforts to diversify its economy, and regional economic integration. Describing his visit as a follow-up to President Nazarbayev's September visit to the U.S., A/S Sullivan underscored USG commitment to strengthening the broad U.S. - Kazakhstan strategic partnership. The Prime Minister welcomed the idea of expanded cooperation, noted that Nazarbayev had directed him to implement the ideas discussed in Washington, and remarked that it was important to strive for early, concrete results. Masimov asked for USG assistance in identifying one or more U.S. companies which might invest in the non-oil sectors of Kazakhstan's economy. Masimov also reaffirmed the GOK's vision of multiple oil and gas export routes, and Energy Minister Izmukhambetov used the occasion to propose a way forward on the Trans-Caspian gas pipeline project: upon completion of the EU- and USG-sponsored feasibility studies, he suggested, the EU, GOK, and USG should consult on a strategy to counter Russian resistance to the project (For more on the Masimov meeting, see par. 17).

12. (C) Summary (continued): Foreign Minister Tazhin raised three topics for discussion with the delegation: the GOK's drive to attract foreign investment and diversify the economy; then-Director of National Intelligence Negroponte's characterization of Kazakhstan as "authoritarian," which Tazhin suggested was "hard to understand and hard to explain"; and Kazakhstan's OSCE CIO bid -- the failure of which, Tazhin warned, could create a "disincentive to further reform," both in Kazakhstan and in the wider Central Asian region. Izmukhambetov and KazMunaigas (KMG) President Karabalin used back-to-back meetings with the delegation to blame ExxonMobil for the current deadlock in CPC pipeline expansion negotiations. While both men encouraged next steps toward developing a Trans-Caspian gas pipeline, Izmukhambetov termed the idea of an equivalent oil pipeline "unsolvable." Minister of Trade and Industry Orazbakov told A/S Sullivan that Kazakhstan was "at the finish line" of WTO accession, while identifying three issues still "to be resolved." Both Kairat Kelimbetov, Chairman of "Kazyna," Kazakhstan's Sustainable Development Fund, and a group of U.S. business executives found merit in the idea of a U.S. - Kazakhstan "public / private partnership," with Kelimbetov remarking that Kazyna embodied a similar goal of ensuring that the government was responsive to the needs of business. End Summary.

Delegation Members

13. (U) Delegation Members: Assistant Secretary of State for Economic, Energy and Business Affairs Dan Sullivan; Principal Deputy Assistant Secretary of State for South and Central Asian Affairs Steven Mann; Deputy Assistant Secretary of State for European and Eurasian Affairs Matt Bryza; USTDA Regional Director for Russia and the CIS, Dan Stein; Lana Ekimoff, Director of the Office of Russian and Eurasian Affairs, Department of Energy; Steve Lucas, a USTDA contractor; and Rob Garverick, EB/ESC/IEC/EPS.

Foreign Minister on Investment, Negroponte, OSCE CIO...

14. (C) FM Tazhin raised three topics in his February 5 meeting with A/S Sullivan. First, Tazhin identified economic diversification and the attraction of foreign investment as a "main" GOK priority. Tazhin heralded the idea of a new, strengthened economic partnership as a replacement for the "mostly failed" 2002 "Houston Initiative." Second, Tazhin told A/S Sullivan that then-Director of National Intelligence Negroponte's January 12 characterization of Kazakhstan as "authoritarian" and "corrupt" was "hard to understand and hard to explain," especially after Nazarbayev's visit to the U.S. Ambassador Ordway replied that Negroponte's comments were analytical and not a reflection of U.S. policy; rather, they were best understood in the context of intelligence community analysis -- which placed a premium, especially

ASTANA 00000460 002 OF 005

after 9/11, on independent analysis, free from any given policy constraint.

15. (C) Third, Tazhin lobbied for Kazakhstan's OSCE CiO bid, arguing that, because Kazakhstan adhered to all OSCE rules, there was no justifiable basis for USG opposition to its CiO bid. Nor was there any precedent: only Turkey's 2003 bid had ever been rejected, Tazhin argued, and then only because of the "special circumstances" of Cyprus and Armenia. Tazhin noted that Kazakhstan would undertake political changes "this year," adding that further "liberalization" of the country was a priority. Still, he argued, the U.S. position was hard to understand, given that Kazakhstan had no political prisoners, no "tragedies" (i.e., Andijon), a record of religious tolerance and tolerance of minorities, an opposition press which "writes anything" -- and had participated in Iraq. If Kazakhstan doesn't get the CiO, he warned, it will create a "disincentive" to further changes, both in Kazakhstan and within the broader region. A segment of the Kazakhstani political elite still adhered to the Soviet past, he said, and if the CiO bid is rejected, it will be hard to convince those elites to continue on the path of liberalization. DAS Bryza responded, telling Tazhin that the USG wanted Kazakhstan to become CiO. "We see a pattern of liberalization," he acknowledged, "but we want the process to move forward." A/S Sullivan added that the U.S. was appreciative of Kazakhstan's economic accomplishments and regional leadership. However, he concluded, economic progress had to be accompanied by political reform.

...Regional Integration, Afghanistan, and Turkmenistan

16. (C) A/S Sullivan noted the small volume of intra-regional trade and asked Tazhin about prospects for regional integration. Tazhin mentioned that one of Nazarbayev's efforts had been to establish "stable organizations" in the region. Water resource management was one area where cooperation was critical; power generation and trade were others. As far as opportunities for Kazakhstani investment, Tazhin noted that Krygystan offered some possibilities, including the tourism industry around Lake Issyk Kul. Uzbekistan, he said, had created "real problems" for Kazakhstan to participate in privatizations.

17. (C) Deputy Foreign Minister Abdrakhmanov discussed prospects in Afghanistan, noting that Kazakhstan's overall approach was based on an assessment of how the GOK should react to an "unstable situation." To that end, he said, the GOK had adopted a government program aimed at creating stability, and was thinking of investing up to \$1 million in humanitarian aid (likely schools or hospitals), probably along with EurAsEC partners. Abdrakhmanov added that, while the GOK couldn't make military contributions to a PRT, civilian contributions might be possible. As far as private investments, Kazyna was looking into opportunities; mining was one attractive sector. Kazakhstani firms had bid on road construction projects in Afghanistan, he said, but without success, as funding countries preferred to give contracts to their own companies. Turning to Turkmenistan, Tazhin mentioned that Kazakhstan had discussed the idea of constructing a gas pipeline from Turkmenistan through Kazakhstan to China; now that Turkmenbashi was dead, however, "those talks will have to be repeated." Asked his opinion about Turkmenistan's future, Tazhin said that he expected little change in the short-term. The new government would likely focus on trying to solve social problems; however, he added, expectations were too high, and the new government would likely face mid-term power struggles.

Energy Issues: CPC and KCTS

18. (C) A/S Sullivan's meetings with Energy Minister Izmukhambetov and KazMunaIGaz (KMG) President Karabalin centered on oil and gas transportation issues. In his opening comments, Izmukhambetov dwelled on problems surrounding CPC expansion, telling the delegation that, while the Government of Russian (GOR) had long held up the negotiations, the GOR's current position on two key issues -- transit tariffs and the composition of the CPC-R Management Committee -- was acceptable to the GOK. Now, Izmukhambetov

ASTANA 00000460 003 OF 005

declared, ExxonMobil was to blame for the deadlock. A/S Sullivan expressed doubt that it was in ExxonMobil's interest to delay CPC expansion. Izmukhambetov characterized the present juncture in the negotiations as "urgent," noting that Putin's term was drawing to a close, the pipeline was being threatened with bankruptcy, and that shareholders still had Russian Energy Minister Khristenko's bid to link CPC expansion to a Burgas-Alexandropolis bypass to deal with. (Izmukhambetov criticized ExxonMobil's position again during the delegation's meeting with Masimov, prompting the latter to laughingly clarify Izmukhambetov's intentions: he wants the USG to pressure ExxonMobil to compromise, Masimov said.)

19. (C) Karabalin updated A/S Sullivan on the Kazakhstan Caspian Transportation System (KCTS) Project, explaining that the recently-signed MOU (between Tengiz producers, Kashagan producers, and KMG) envisaged the creation of two working groups -- one to tackle design issues and the other to negotiate with the GOK. Karabalin expressed concern with the number of actors involved in the project, as well as with Azeri demands for high transit tariffs. Both the Azeris and the BTC Co. needed to accept that the biggest profits should come from oil production itself, Karabalin concluded, and not from fees and tariffs levied on the use of the BTC pipeline.

Energy: Trans-Caspian Pipelines

110. (C) Discussion of Trans-Caspian pipeline options was framed by A/S Sullivan's observation that, given that the

vast majority of Kazakhstan's oil and gas exports transited Russia, the country would be well-served by alternate routes. DAS Bryza articulated USG motives for backing a gas pipeline as a desire to provide secure gas supplies to Europe, while ensuring that producers earned fair market value for their gas. Izmukhambetov's assessed prospects for a seabed oil pipeline differently than those for a gas pipeline. Russian and Iranian opposition, as well as a "five-country agreement to coordinate all Caspian Sea infrastructure projects," rendered the idea of an oil pipeline "unsolvable." To press forward with the idea of a Trans-Caspian oil pipeline, he added, would be to "risk the gas pipeline project." PDAS Mann replied that the USG was not aware of any "five-country coordination agreement." Neither Iran nor Russia would ever give Kazakhstan approval to go forward with a Trans-Caspian pipeline, he added -- nor was their approval necessary. Legally, he said, a pipeline could be built upon the agreement of only two Caspian littoral states.

¶11. (C) In contrast to Izmukhambetov's skepticism about a Trans-Caspian oil pipeline, all of the delegation's GOK interlocutors encouraged further progress on the gas pipeline project. However, both Karabalin and Izmukhambetov expressed doubts about short-term Kazakhstani gas supplies. Karabalin explained that most of the country's gas would be reinjected in the near-term, making the development of the pipeline "depend mostly on Turkmenistan's position," while Izmukhambetov noted that supply of gas would be a long-term issue. Izmukhambetov would reject the idea of a Trans-Caspian oil pipeline as "unsolvable" while supporting progress on a gas pipeline. One possible explanation lies in the fact that Kazakhstan gets market prices for its oil which transits Russia, but far from market prices for its gas -- making both the benefits of a gas pipeline more evident, and the effects

ASTANA 00000460 004 OF 005

of possible Russian reprisals in the gas sphere less severe. The GOK may also be accepting at face value the oft-repeated argument that the environmental risks of an oil pipeline exceed those of a gas pipeline. As A/S Sullivan pointed out to Tazhin, however, the correct comparison to make is between the environmental and safety risks of an oil pipeline and those posed by tanker shipments. The fact that Tazhin eagerly asked for information backing this argument is promising. (Tazhin also asked for an elaboration of the USG's legal view of the Caspian delimitation issue, as it related to the pipeline projects.) The GOK's strongest objection to the idea of a Trans-Caspian oil pipeline, however, may be that GOK insiders appear well-poised to profit from the port and tanker traffic now planned to transport Kashagan and second-generation Tengiz oil to Azerbaijan, while no equivalent profit-making opportunities exist -- at least yet -- in the transport of gas. Failure to agree on CPC expansion, however, could re-focus the GOK on an oil pipeline if there are no other feasible routes with the capacity to accommodate Kazakhstani volumes after Kashagan production ramps up, sometime in 2011 or later. End Comment.

WTO, Trade, Diversification

¶13. (C) Minister of Industry and Trade Orazbakov told the delegation that, as robust as Kazakhstan's "strategic" economic relationship was with the U.S., Kazakhstan wanted to expand economic ties. 2006 trade turnover was \$1.6 billion, he said; "we want 3-4 billion in a few years." The U.S. had invested \$10.3 billion in Kazakhstan, Orazbakov remarked, but with Kazakhstan's drive to diversify the economy, much more was needed. (Note: our figure is higher, around \$14 billion.) Orazbakov lauded General Electric plans to assemble locomotives in Kazakhstan, suggesting that the transportation sector offered additional investment opportunities. Kazakhstan, he remarked, was seeking a U.S. partner to enter the small (2-4 person) business airplane market. Turning to WTO accession, Orazbakov told A/S Sullivan that Kazakhstan was "at the finish line." Orazbakov cited "three issues that need to be resolved": Kazakhstan's need for transitions on "banking / insurance branching" and "an economic needs test for labor," and "GMO's": "we don't know what this issue is about," he confessed.

¶14. (C) Kairat Kelimbetov, Chairman of "Kazyna," Kazakhstan's Sustainable Development Fund, described for the delegation how the various Kazyna entities had been established to target key development needs: one issued long-term debt beyond the reach of private banks; another provided non-oil and gas equity financing; a third funded development of SMEs; another, state insurance for exporters; and, finally, the National Innovation Fund attempted to bring new technologies to Kazakhstan. Kelimbetov then explained how Kazakhstan had used Michael Porter's "cluster theory" to identify seven priority sectors for economic diversification. A/S Sullivan asked Kelimbetov how Kazyna and the private sector worked together, explaining the USG idea of a "public/private partnership" as a way to involve companies, with their "action / transaction" orientation, in the realm of policy-making. Kelimbetov voiced enthusiasm for the approach, noting that Kazyna, as well, strives to create a forum in which business could discuss and recommend changes in government regulations and procedures.

U.S. Business Perspectives

¶15. (C) Before his discussions with GOK officials, A/S Sullivan met with representatives of U.S. businesses operating in Kazakhstan. The business executives described several challenges to doing business in Kazakhstan -- including ever-changing central and local government interpretation of the law, and a tendency of the authorities to use environmental fines and tax audits to erode contract sanctity -- while characterizing the situation as "business as usual" rather than "a crisis state." An oil and gas lawyer described the Chinese as "very active" in Kazakhstan,

retelling how a "high-ranking" Chinese National Petroleum Company (CNPC) official had told him that China's drive to acquire oil and gas assets was motivated by a fear of being "blockaded."

ASTANA 00000460 005 OF 005

¶16. (C) The executives lauded Kazakhstan's goal of economic diversification, but identified more obstacles -- including an immigration policy that was too restrictive for a country with a booming economy and small population -- than concrete opportunities. Similarly, regional integration would be a challenge, they suggested, given the current low volume of intra-regional trade and the challenges posed by Kazakhstan's neighbors, especially Uzbekistan. Asked about U.S. efforts to encourage Kazakhstan to assume a regional leadership role, the executives suggested that, while there was no historical precedent, Nazarbayev clearly wanted to enhance Kazakhstan's regional and global status. On balance, the objective was laudable, but perhaps only realizable long-term. Finally, the executives reacted positively to the idea of a USG-GOK 'public / private partnership.' Ken Mack, President of the American Chamber of Commerce, and Dennis Price, Chairman of Kazakhstan's Foreign Investors' Council Association, briefed A/S Sullivan on their organizations, with an eye toward playing a role in such a partnership.

Masimov: Summing Things Up

¶17. (C) A/S Sullivan concluded his visit by meeting Prime Minister Masimov, who convened all of the GOK officials who had met separately with the delegation earlier in the day. Masimov focused on results, asking each minister to summarize the outcome of earlier discussions with A/S Sullivan. He then pointed out that the list of topics discussed was a "familiar one." "I already have a directive from the President to implement these ideas," he said, "and I will try to fulfill it." Masimov explained that his emphasis was on delivering practical results "within a two-year period."

¶18. (C) Turning to specific issues, Masimov declared that U.S.- Kazakhstani energy cooperation was "progressing" toward a shared vision of multiple export routes. On the topic of gas transportation, Masimov declared that, personally, he preferred the idea of CNG or LNG to a pipeline, but the actual means of transportation was "negotiable." (Later in the meeting, Dan Stein summarized a USTDA-sponsored study demonstrating that a pipeline presents better netbacks than other gas transport options. Earlier in the day, Steve Lucas, a USTDA contractor, presented the study to an audience of KMG and Energy Ministry experts.) On the KCTS process, Masimov mused that perhaps the GOK "should cooperate more" with the Azerbaijani government and private companies in order to move forward. Regarding diversification, Masimov asked for USG help in attractive one or more large companies to invest in the non-oil economy -- perhaps in agriculture -- as a showcase to attract further U.S. investment. Finally, Masimov reaffirmed his approval of the idea of a "public/private partnership,"

¶19. (U) A/S Sullivan has cleared this cable.
MILAS